

Role of Political Instability in Trade Pattern and Economic Growth: A Case of Pakistan

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Abstract

Economic growth is based on the foreign investments and international trade based on stable and consistent policies. Stable political and economic policies attract the foreign investments and international trade. Political instability affect the foreign investment and economic growth. The role political instability has been tested on the pattern of international trade and economic growth. The results shows that terms of trade insignificant while trade restriction indication a significant impact on economic growth. Trade patterns indicates a significant relationship with economic growth. The results indicates that political instability affect the relation of trade pattern and economic growth adversely as moderating factor. It has been observed that political instability is quite high in case of Pakistan. Since last ten years political system of Pakistan is improving after the revival of democratic system and trade with neighboring and developed countries is improving and a positive signals has been observed in economic growth of Pakistan

Keywords: Trade, Economic Growth, Political Instability, Pakistan

Introduction

In developed countries the level of poverty is relatively low as compared to underdeveloped or developing countries, while the economic growth rate of developed economies is relatively high (Iniguez-Montiel, 2014). Furthermore, the previous study related to cross country indicates that developed economies achieve fast and continue growth in an economy (Lin, 2011). Recent literature documented that fast and continued economic growth has positive and significant relationship with Patterns of trade (Outreville, 2013). Imports of capital nature products like latest technology, machineries and knowledge and exports of final products leads towards the economic growth and economies achieve the comparative advantage of others (Shimbov, 2016).

However, production capacity of economies vary, development economies outsource most of its operations and productions to developing economies and achieve competitive advantage because developing economies have cheap labor while the developing economies like Pakistan unable to achieve fast and consist economic growth due to number of factors; import raw material, technology, knowledge, technical skills and the most important is supply of electricity (Macchion et.al, 2015). Pakistan industry faces high level of electricity shortfall, while adversely affect the productions, operations and ultimately leads to lower productions and exports (Hong, 2014). Electricity shortfall badly affect the textile sector of Pakistan, it has been observed that most of the industrial unit in

textile sector closed and some of them moved from Pakistan to other countries due to electricity shortfall (Kessides, 2013).

While, remaining companies start their own plants for electricity generations (Ali, 2015). In addition to that, Khan (2014) describes that textile industry is main part of Pakistan in agriculture sector. Moreover, it is the foundation of Pakistani economy. Electricity is an important part of our economy and large part of electricity is involved in productivity and utilization processes in our economy (Ellabban et al, 2014). Over the past decades Pakistan has increase Gross Domestic Product (GDP) and high level of electricity production. The level of industrial production, economic growth and level of employment is badly affected due to electricity shortfall (Ahmed et al, 2013).

Electricity shortfall is the main reason to affect the Textile sector of Pakistan because large part of GDP (Gross Domestic Product) of Pakistan is significantly by textile industry, exports and employment (Ahmad & Bashir, 2013). Textile industry has developed 1550 million kgs of yarn, 4368 million square meters of fabric related to weaving capacity and 4000 million square meters of fishing capacity (Essays, 2013).

Cotton is an important part of textile industry in terms of raw material. It is developed 3-million-hectare scale by 26% of agriculture. The huge portion of cotton 80% developing in Punjab and the rest of 20% is developing in Sindh. The GDP of Pakistan is

8% and employment is 17% and foreign exchange earnings are about to 54% (Javid & Sharif, 2016). Cotton was banned due to some reasons related to trade. Recently, Pakistan has endorsed different types of trade but twist infection, food security and meal bugs are in process to endorse by Pakistan (Fader et al, 2013). Government of Pakistan has different projects related to cotton for improvement of textile sector and endorse different types of new cotton diversifications (Abdul Ghafoor, 2015).

Cotton is the main cash crop in china and useful commodity in different countries for agriculture provides benefit in terms of rural areas (Smyth, Kerr, & Phillips, 2015). Moreover, cash generated from cotton crop utilization needs for farmer families and provides the raw material in terms of basic production for household markets as well as exports point of view (De Haas, 2017). At domestic level cotton is the main source to earn finance and provides benefits to farmers internationally (Cheru & Modi, 2013).

Vietnam's cotton yarn is a basic import raw material in china and the value of import approximately 625'000 tons in 2016\2017, the value of exports in terms of accounting is 84% of Vietnam's total cotton yarns (Xinping, Clever , & Wu, 2016). Pakistan should foot a bill of around \$1.58 billion for the import of 4.5 million parcels (170kg each) to overcome any issues between the generation and utilization of crude cotton. Cotton creation timed up at 15m parcels in 2014-15 and 9.5m banches in 2015-16. It is relied upon to be around 10.54m bundles in 2016-17. Pakistan was the third biggest crude cotton exporter, yet it has been a shipper throughout the previous two years. A year ago, Pakistan imported around 2.7m banches from India at a cost of \$800m (Rana, 2017).

Trade free Agreement

Trade free agreements facilitate the economies in boosting their trades among the neighbor countries based on the gravity model of International trade, by eliminating the barriers countries/ industries faced in trade (Kahouli & Maktouf, 2015). According, to World Trade Organization (WTO) total number of regional trade agreements around the globe is around 700 in total (Wübbecke, 2013). In south-Asian region several countries decided and signed a number of trade free agreements among neighbor economies based on the trade patterns (Iapadre & Tajoli, 2014). Pakistan sign several trade free agreements with neighbor countries including, India, Bangladesh, Sri-Lanka and China. Pakistan sign a number of trade free agreements with China because China has been biggest rapid growing country for so many years, now it is the second biggest country (Bergstrand & Egger, 2007). China Pakistan Free Trade Agreement (CPFTA) on 24th November 2006, which came into effect in July 2007 (Ezeani, 2018). Free Trade Agreement is the main source to boost the relationship between countries and help to increase economic growth of the member countries (Baier & Bergstrand, 2007) . Gray (2014) describes that comparative advantage is occurred due to Regional Trade Agreements (RTAs), in this way economic growth of countries increased due to benefits of excess resources/factors.

The trade of different products like cotton fabrics, other home textiles, bed-linen, leather related stuff, sports material, fruits and vegetable include many other commodities through Free Trade Agreement with china give best advantage as compared to other countries (Tiefenbrum, 2013). Furthermore, these products are comparatively high-growth products in any country of the world (Scott, 2008).

The initial purpose of this agreement is to provide bilateral trade and create large number of market entry to the commodities in terms of common basis (Baldwin & Lopez-Gonzalez, 2015). According to Tariff Reduction Modalities (TRM), during first three years both countries decided to remove taxes almost 36 percent of the total tax applicable of Phase-I and that is finished in 2012. The second step of this agreement is not decided yet but in which included all taxes and better trade procedures will be made in near future and agreement on trade acceptance is still in process (Junaid & Malik, 2017).

Early Harvest Program (EHP) is an agreement, in which the relationship between china and Pakistan is stronger and it is

performed on January 1, 2006 (Kataria & Naveed, 2014). This agreement was basically the initial step moving towards free trade sector, furthermore China and Pakistan provides a market entry on a large scale to each other on the products of important trade interests (Hussain & Khan, 2017).

The China –Pakistan Economic Corridor (CPEC) is main source to provide facilities not only to Pakistan and china but also for the entire economy (Sial, 2014). The main aim to create this network for roads, railways and different energy projects, the main purpose for this network is linkup Pakistan's Gwadar port to the China's Xinjiang province, besides helping Pakistan in improving its supply side constraints (Brewster, 2017).

Objective of Study

The objective of this study will be:

- To investigate the impact of trade pattern (imports & exports) of cotton on economic growth of Pakistan and china.
- To identify the moderating effects of electricity shortfall on economic growth of Pakistan and china.
- To explore the direct effect of electricity shortfall on economic growth of Pakistan and china.
- To explore the direct effect of electricity shortfall on Trade pattern (imports & exports) of cotton.

Significance of study

- The significance of this study is to investigate the impact of imports and exports of cotton on economic growth catching up with the recently rapid technological advances in production.
- This study is helping to increase the economic growth of Pakistan by exporting cotton and china by importing cotton.
- This study also helps the farmers and to educate in proper manner with available facilities and it will explore new ways to improve our social; and natural resources as well for the cotton production at large scale.

Literature Review

Import and Export of Cotton

The second largest share after United States which is 16.7 percent in Pakistan is China with 7.7 percent of share in export (Uprasen, 2016). The main export of Pakistan towards China is cotton and rice which is 75 percent of the total export of Pakistan to China (Lenzen et al, 2013). The most important thing is that export is increasing between these countries as in 2006 it was up to 358 million US dollar and in 2016 it increased to 968 million US dollar (Yeeles & Akporiaye, 2016). China has become one of the largest importers of cotton Yam after Bangladesh. (Junaid & Malik, 2017). There was downward trend of growth rates and imports were showing the negative whereas the export of cotton was showing strong trend of upwards (Leslie & Stephen, 2016).

Pakistan should work to remove the hurdles which comes in the area where they are strong in exports which not only includes cotton yarn but also cotton fabrics and other products of cotton which are exporting to China (Islamx et al, 2013). An estimated percentage of export is 80% containing cotton in raw form and cotton yarn. (Noor, 2014). The positive impact in liberalization of trade and growth in economic internationally which leads towards favorable economic environment among exports in South Africa which has been proved by their study (Sofia Anwar, 2010).

The imports in 2016 decreased in different countries in which China's dropped up to 30% of cotton yarn which had worth of 960 million kgs amounting US\$2,430 million, whereas there is also noted that export of India also decreased up to 49% which is of 231 million KGs having worth of 560 million US dollar. In the same year there were total imports if 159 million KG which worth 400 million US dollar while in 2015 the import was of 593 million US dollar against 216 million KG. The average price of imports of cotton yarn is comparatively less than China India and Vietnam which was 2.14 US dollar and 2.51 in China, 2.40 in India and 2.55 from Vietnam (Times of Islamabad, 2016).

Role of Political Instability

Political stability is a vital or considered as founding factor for the economic development and consistent growth of a country. While an unstable political system can hamper the industrial as well as economic growth. The theme of political instability was defined by Lipstel (1960) as “a country is considered as stable if it has been a liberal and consistent democracy or dictatorship for 25 years”. However, modern school of thought documented political instability as “efficiency of government system and policy objectives”.

Prior literature indicates that instable and volatile political system affect the economic growth. Political system affect the system in two ways firstly, it affect the private investment which affect the economic growth and secondly, it affect the purchasing capacity of people which affect the economic growth. Private investments from the multinational companies boost trade potential of any economy and ultimately boost it economic growth.

Due to political instability there is governments’ constantly change their policies and come up with new decisions so, it is really hard for the risk averse agents/ investors to invest in political instable country. Investors more prefer to invest in a country with lower political instability or with stable economic environment even with lower returns (Alesina & Perotti, 1996; Barro, 1991).

Inconsistency or consistent variation has been observed in economic growth of Pakistan since 1970. Pakistan’s economy is facing aftershocks political instability after the war of 1971. War of 1971 affect the economic growth of Pakistan in terms of capital and human resources. Pakistan recover from the war of 1971 and enjoyed a sustainable growth till 1988 due to afghan war. Afghan war and due to consistent changes in governments affect the political and economic policies of Pakistan. Irrational and inconsistent policies affect the economic growth of Pakistan.

Research Methodology

The subject of study is Trade Pattern of cotton and economic growth with moderating role of electricity shortfall. This research follows the quantities technique to achieve the research objectives. Quantitative nature of data will be collected to achieve the research objectives of current study. To achieve the research objective current study 20 years data will be employed and next 20 years will be forecasted to test the relationship of trade patterns of cotton and economic growth data will be collected from Index Mundi and World Bank Indicator.

To test the effect of trade patterns on economic growth with mediating role of electricity shortfall, regression technique will be

employed. To test the direction of relationship granger causality technique will be employed. All the assumptions of regression technique will be employed before the application of regression technique. Moreover, to test the granger causality technique, unit root test will be employed.

Table 1: Descriptive statistics

	Mean	Std. Deviation	N
GDP	4.93	2.39	67
Political Instability	1.38	1.23	67
TOT	2.19	3.21	67
TR	.009	.012	67

In descriptive statistics presented in Table 1 (comparing means and SD’s of GDP (Growth

Rate), Political instability, Term of trade and trade restrictions. In this table the values of political instability and trade restrictions is better, stable and consistent whereas the values of GDP and term of trade is volatile.

Table 2: Correlations Analysis

	GDP	Political Instability	TOT	TR
GDP	1			
Political Instability	.051	1		
TOT	.206	-.148	1	
TR	.397	-.423	.159	1
N	67	67	67	67

This table demonstrates the relationship between variable with significant and insignificant level. Therefore, the relation between the GDP and political instability is $r = 0.51$, shows weak positive and significant relationship between GDP and political instability as P value is less than 5%. The relationship of political instability and term of trade is $r = -0.148$ shows negative and insignificant relationship as P value is greater than 5%. The relationship between term of trade and trade restrictions is $r = .0159$, shows that weak positive and insignificant relationship as P value is greater than 5%.

Table 3: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error Est	Change Statistics			Durbin-Watson
					R Square Change	F Change	Sig. F Change	
1	.051 ^a	.003	-.013	2.41	.003	.171	.680	
2	.494 ^b	.244	.208	2.13	.241	10.037	.000	1.380

R square value is about .003 which means that 0.3% variation is GDP is explained by political instability and for GDP R- square value is .244 which shows that 24.4% variation due to political instability, term of trade and trade restrictions. The value of F-

statistics shows that model is GDP with political instability is not good fitted model. While the model trade restrictions is good fitted model according to F – statistics value.

Table 4: Moderated Regression

Model		Unstandardized Coefficients		Standardized Coefficients Beta	t	Sig.	Collinearity Statistics	
		B	Std. Error				Tolerance	VIF
1	(Constant)	4.79	.445		10.77	.000		
	Political Instability	.100	.241	.051	0.41	.680	1.00	1.00
2	(Constant)	3.01	.561		5.37	.000		
	Political Instability	.550	.236	.283	2.33	.023	.81	1.22
	TOT	.127	.083	.170	1.52	.132	.97	1.03
	TR	3.19	25.64	.489	4.02	.000	.81	1.23

In model 1 the P-value of (b₁) is .680 shows insignificant relationship between GDP and political instability which is greater than 0.05. In model 2 the P- value shows the significant results in terms of the relationship between GDP and political instability as a moderator variable. In model 2 the P- value of term of trade and trade

restrictions is 0.132 and .000 shows insignificant relationship between GDP and term of trade and significant relationship between GDP and trade restrictions.

Conclusion and Discussion

International trade is considered a key factor in economic growth. Trade liberalization facilitate the economies to achieve high level of growth rate through international trade. Economies boost their international trade through trade free agreements and based on the gravity model. International trade bring foreign investments and prosperity to the economy. Political and economic stability effect the economic growth and trade patterns. Trade patterns is solely based on the political agreements and how countries are politically or economically associated with each other. Countries with political instable lose their trade with neighboring countries and other developed and developing countries which ultimately affect the economic growth.

The results affirms that trade patterns positively and significantly improve the economic conditions and growth. However, economy of Pakistan is facing the factor of political instability. Political instability affect the relationship of trade patterns and economic growth as moderating factor. Economy of Pakistan is suffering from irrational and unfavorable political and economic policies. Since 1970, Pakistan's economy is facing issues and challenges in terms of democratic political governments and due to instable economic policies.

Future research need to test this relationship on neighboring countries or developing countries like Pakistan. Government of Pakistan needs to focus on economic policies and these policies should be favorable to investors so foreign investment should inflow to Pakistan. Government should also focus trade policies to enhance the exports of Pakistan which ultimately increase the economic growth.

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